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HUTA SZKLA JAROSLAW S.A.
POLAND

Final

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HUTA SZKLA JAROSLAW S.A. (A)

POLAND

On the evening of January 2, 1994, the recently privatized Huta Szkla Jaroslaw S.A. (Jaroslaw) awaited the arrival of its new Managing Director, Montgomery Jones, who has been appointed by its American parent company, Owens-Illinois Inc. (O-I). Jaroslaw was the largest producer of glass containers in Poland. The new management of Jaroslaw would be facing the challenges that many other formerly state-owned companies were facing: management reorganization, production operations management overhaul, financial planning, market development, labor force downsizing and compliance with environmental regulations in a new operating environment.

Adam Kowalski, who joined Jaroslaw as a Management Advisor on October 1, 1993, was in a unique position to provide strategic advice to the new Managing Director. Over the past two years, Adam was intimately involved in the financial analysis and other tasks associated with Jaroslaw's privatization while he was a consultant at Price Waterhouse's International Privatization Group in Warsaw. Knowledgeable about Jaroslaw's operations, young, bright, and fluent in English, Adam Kowalski represented a new generation of Polish managers who would be instrumental in bridging the gap between western business practices and the Polish operating conditions.

To assist Mr. Jones in the restructuring process, Adam Kowalski had been asked to evaluate the company's current market and production operations management, and identify actions to improve the company's performance. Given the broad range of challenges facing the company in the marketing and production ends, it would be important to determine which areas should be addressed first, and which actions could wait.

Industry Overview

From 1991 to early 1992, unfavorable economic conditions resulting from the so-called economic "shock therapy" reduced purchasing power and depressed demand in the Polish glass packaging sector. The expansion of the sector since mid-1992 was propelled by rapid private sector growth

This case study was written by Ophelia Yeung and Peter Boone of SRI International, under the supervision of the International Privatization Group of Price Waterhouse as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The study was undertaken through the Privatization and Development (PAD) Project funded by the United States Agency for International Development (USAID), August 1994.

and the overall recovery in the Polish economy. The domestic market for glass containers grew 5 percent in 1992, and 17 percent in 1993 to reach Zl. 4,273 billion ($236 million).[2]

The domestic market drew upon Poland's population of 38.3 million whose per capita consumption of glass containers was 16.7 kg in 1993. As national income rose, glass container consumption in Poland was expected to gradually approach the current European Union (EU) level of 44.6 kg/capita or the U.S. level of 39.7 kg/capita.

Company Background

Jaroslaw's Privatization History

Founded in 1974, the Jaroslaw plant was located in the southeast area of Poland 52 km east of Rzeszow. In January 1994, it was the most recently built of the twelve glass container plants in Poland.

Responding to the national privatization policy, Jaroslaw's management and Worker's Council voted in favor of privatization through capital transformation in the spring of 1991. In September of the same year, Jaroslaw was officially transformed into a joint stock company wholly owned by the State Treasury as represented by the Ministry of Privatization (MOP). It was anticipated by the management, labor, and MOP that a majority share of the company would be sold to a strategic investor within two years.

Two bids were received by MOP in response to the tender it released in mid-1992. One offer was submitted by the American company, Owens-Illinois Inc. A bid was also received from the Swedish and German firms, PLM and Heye.

Although the PLM-Heye bid was initially favored by MOP staff, negotiations were discontinued by MOP following the union's and workers' expression of dissatisfaction with the PLM/Heye bid. Dissatisfaction with the German partner of the joint venture bid was intensified when Heye decided to call its outstanding capital loan of DM 6 million (US$ 3.9 m) to Jaroslaw in February 1993, plunging the company into an immediate liquidity crisis. At that point, union representatives expressed that the workers overwhelmingly favored O-I. MOP then invited O-I to negotiation, which culminated in a share purchase agreement signed on September 16, 1993.

On December 20, 1993, the State Treasury sold 36 percent of Jaroslaw's shares to O-I and its partners for $3.15 million. Twenty percent of the shares were to be set aside for purchase by workers at preferential terms. The agreement also stipulated that the remaining shares of

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Average exchange rate was Zl. 18,115 per US Dollar for 1993.

Jaroslaw would be acquired by O-I and its partners from the State Treasury in four to five years.

Simultaneously to the share purchase transaction, O-I and its partners increased the share capital of Jaroslaw by issuing new shares which added $14.05 million to the company's authorized capital. O-I's financial partners included the New Europe East Investment Fund, the Polish-American Enterprise Fund, the Polish Private Equity Fund and the East Europe Development Fund. As a result of the share dilution, the outstanding shares with MOP were reduced to 16.9 percent of the company's authorized capital and the workers' share was reduced to 7.7 percent of the total equity (Exhibit 1). The additional capitalization was used to meet the working capital needs of the company (Exhibits 2 and 3).

As part of the share purchase agreement, O-I agreed to provide both employment and social benefits guarantees for the 18-month period from September 16, 1993. O-I and its partners also committed to invest no less than $25 million in the company during the five year period after the share purchase. Beyond that commitment, O-I also indicated interest in making an additional capital investment of $16 million, depending on market prospects. O-I had obtained a commitment from the European Bank for Reconstruction and Development (EBRD) for a loan of up to $43 million to fund a capital investment program.

Financial Situation of Jaroslaw

Throughout 1993 Jaroslaw was operating under a very weak financial position for several reasons. As a result of the unstable economic environment, many of Jaroslaw's former customers became insolvent and were unable to fulfil their payment obligations to Jaroslaw. Prices of Jaroslaw's products also lagged behind inflation, especially in export sales for which the exchange rates depreciation of the Zloty did not adequately reflect the increases in producers' costs in Zloty.[3]

Of course, the financial crisis in Jaroslaw was precipitated by the unexpected calling of the capital loan by Heye. BDK Lublin, the bank guarantor of the loan, made the payment on Jaroslaw's behalf and rescheduled payment from Jaroslaw in six equal installments commencing in March 1993 at 43 percent interest. The loan payment, however, immediately worsened Jaroslaw's working capital condition. During 1993, Jaroslaw's liquidity was precariously maintained by postponing salary increases, delaying the settlements of accounts payable, as well as shelving equipment and machine repairs.

The exchange rate for the Polish Zloty declined from Zl. 15,767 per US Dollar as of January 1993 to Zl. 21,344 per US Dollar as of January 1994, representing a 35 percent depreciation. During the same period, producer prices in Poland had risen 43 percent.

Company Background of Owens-Illinois

The new owner of Jaroslaw -- Owens-Illinois Inc. -- was founded in 1914. O-I was the largest glass container producer worldwide, as well as the leader in glass container technology. As of January 1994, O-I operated 22 glass plants in the United States. Over the past few years, a key element of O-I's strategy had been to look for growth opportunities overseas. Prior to its acquisition of the Jaroslaw plant, O-I had acquired full or partial ownership of 10 plants throughout the United Kingdom, Mexico, South Africa, and six plants in South America. In 1993, O-I and its affiliates employed over 33,000 staff and earned revenues in excess of $3.6 billion. In addition, O-I also had technology license agreements with plants in 33 countries.

O-I's interest in the Jaroslaw plant was primarily driven by the desire to penetrate the emerging markets in Eastern Europe, and its existing strategic alliance with the international processed food company, Gerber. Gerber recently invested in a privatized food processing plant in Rzeszow, Alima, and was viewed by O-I as a potential source of steady business for Jaroslaw, since Alima was Jaroslaw's major customer. Because Jaroslaw was the first plant acquired by O-I in Eastern Europe, O-I had brought in additional financial partners to share investment risks initially. However, it was the intention of O-I's senior management to upgrade Jaroslaw's production capability using O-I technology, and to eventually acquire full ownership of the Jaroslaw plant.

Future Marketing Direction

Historically, Jaroslaw and other Polish glass manufacturers had made substantial sales to other Polish state-owned enterprises and to former Soviet bloc countries. The collapse of the former Soviet bloc's several markets and the liquidity problems among many former state-owned plants had led to the disintegration of Jaroslaw's former customer base. Like many Polish glass manufacturers, Jaroslaw was under increasing pressure to develop new markets both domestically and abroad.

In 1993, Jaroslaw shipped 818 million units and earned Zl. 809.8 billion ($44.7 million) in revenue. Jaroslaw's main markets were processed foods, soft drinks, beers and spirits (Exhibit 4). Jaroslaw's customer base included some of the largest and best known food processing and beverage companies in Poland: Alima-Gerber (food), Ovita-Nutricia (food), Winiary (spices and food), ZPOW's (food and beverages), Polmos (vodka), Hortex (food and beverages), Pepsi Cola, Coca-Cola, all main breweries, and mineral water producers.

Domestic Market Prospects

The glass container industry in Poland consisted of 12 manufacturers, 11 of which were state-owned companies. Jaroslaw was the first glass container plant to vote for transformation into a joint stock company and was the only company whose majority share ownership had been acquired by strategic investors. Other state-owned companies had been undergoing various stages of transformation and liquidation at that time.

The Polish glass market was very price sensitive. Jaroslaw's products had been particularly competitive in the Polish market in terms of price and quality. Jaroslaw had developed a domestic reputation for its technological advantage and superior quality products compared to other Polish producers, and offered the installed capacity for accommodating large volume orders. Jaroslaw was the only domestic manufacturer with equipment and quality controls capable of producing lighter weight, nonreturnable beer bottles, for example. Generally, the quality requirements (weight, durability, homogeneity, and design) in the domestic market were below Western standards, but were expected to rise gradually to approach Western standards over the next five to ten years.

In response to the rise in the quality and specification requirements, it could be possible that Jaroslaw's domestic competitors would upgrade their production technology with the help of international joint venture partners. The entry of "green field" plants was also a possibility, although no international glass container manufacturers had yet expressed interest in doing this. In addition, Poland's labor cost advantage against its western neighbors could be eroded in the medium term, inviting imports to compete with domestic glass manufacturers. In view of the market dynamics, the new management of Jaroslaw would need a long term strategy to maintain competitiveness in the domestic market.

Recent trends among major glass container users in Poland pointed to healthy medium-term growth in the industry. Overall, healthy economic growth in Poland (real GDP growth at 4 percent in 1993, the highest in Europe) would likely increase the demand for soft drinks, beer, processed vegetables, sauces, and other glass packaged goods.

In the beer and spirit industries, the demand for nonreturnable bottles was expected to grow 10-15 percent in 1994, and at present accounted for 30 percent of the Polish market. The growing popularity of nonreturnable bottles would raise the overall demand of glass containers in Poland. Polish spirits producers were also expanding aggressively in the export markets, boosting demand for glass bottles. At the same time, sales prospects had been improving in the food sector with the new investments made by several multinational food producers in Poland.

In the long term, rising environmental consciousness in Poland would favor glass packaging, which was considered to be environment-friendly in view of existing recycling technologies.

Import of glass containers into Poland remained small and insignificant. In terms of volume, the share of domestic sales industry-wide increased from 79 percent in 1991 to 90 percent in 1993. There was a 15 percent tariff for imported glass containers.

Exports Versus Local Market

Jaroslaw exported 18 percent of its production in 1993, making it one of the major glass container exporters in Poland (Exhibit 5). Jaroslaw's main direct export had been in amber beer bottles, particularly to Germany in recent years.

The export markets might offer Jaroslaw growth opportunities particularly in association with increased multinational investment in plants in Eastern Europe to supply markets in Russia, Ukraine and other former Soviet republics. In the EU market, prospects for glass suppliers were improved by the recent restriction on import of fresh produce from Poland.

However, the export market was extremely price-sensitive, and customer loyalty had proven to be low. Export sales were often less lucrative than domestic sales after paying commissions to in-country intermediaries. In addition, not all of Jaroslaw's products would meet the quality, design and customer service requirements in the highly competitive EU markets.

Sales and Distribution

Most domestic sales were made without the use of intermediaries. The majority of Jaroslaw's domestic customers placed orders only several weeks before the desired delivery date. Less that 20 percent of the domestic sales were governed by contracts of longer than six months. Client liaison was primarily undertaken by the Director of Trade who had maintained very good customer relations.

Until 1989, Jaroslaw had exported solely through Minex, the central trading organization for the Polish glass industry under the former socialist system. Minex charged a 5.5 percent commission. Since 1989, Jaroslaw had cultivated its own export client base and only engaged the service of Minex for part of its export sales. However, Jaroslaw had no export sales force, so it engaged local intermediaries to sell its export products and hired local trucking companies to provide transport services.

Production Operations Management

To pursue its new strategic marketing direction, Jaroslaw likely would require an overhaul of its production operations management (POM) to reflect the realities of its new operating environment. In October 1993, Jaroslaw had signed a technical assistance agreement with O-I in order to implement new production equipment technology and practices. O-I technicians estimated that technological upgrades at the Jaroslaw plant would require considerable capital expenditure, possibly in excess of $50 million over the next five years.

Plant Management

The management structure of Jaroslaw was inherited from its state-owned predecessor, and as such reflected the production organization, management and marketing practices under a socialist economic environment . The challenge would be to reorganize Jaroslaw's existing Management Board (Exhibit 7) to establish a management structure that would reflect Jaroslaw's new operating environment and marketing focus.

The new Management Board of Jaroslaw would be appointed and supervised by the Supervisory Board. The members of the Supervisory Board (Exhibit 8) were elected by the shareholders.

In January 1994, the General Director, Miroslaw Nowak, who had excellent relations with the unions, was replaced by an O-I manager, Montgomery Jones. The Finance Director was replaced by Gregory Smith from O-I United States (Exhibit 9). The new expatriate management expressed a desire to draw extensively from the experience of the former management board and to offer them new positions in the organization. Jones especially wanted to keep Nowak.

With one exception (Jan Kisel - Director of Trade), all of the former directors had been with the company for nearly 20 years. All had a reputation for maintaining good relationships with union leaders.

Jaroslaw's Product Lines

Jaroslaw produced both flint and amber glass containers[4] ranging from 0.2 liters to 1.0 liters. The main products include: bottles for beer, wine, vodka, milk, soft drinks, juices and mineral water, and wide-mouth jars for processed foods. Jaroslaw had also been producing bottles for chemicals and cosmetics on a small scale.

In recent years, glass jars had accounted for an increasing share of Jaroslaw's sales revenue. Within the bottle product group, spirits had accounted for an increasing portion of both sales volume and revenue against that of beer and soft drinks (Exhibit 10).

Flint glass here refers to the type of clear glass used in Jaroslaw mostly for jars, vodka and other liquor bottles. Amber glass refers to the brown glass used mostly for beer bottles.

Jaroslaw had reduced its market exposure to the soft drink sector since 1991 due to the poor payment records of many customers, the seasonality of the sales, and the aggressive price competition in the sector.

Over the past two years Jaroslaw, had lowered product prices in real terms (Exhibit 11) to remain competitive even though operating costs had risen faster than inflation resulting in a decline in operating profit margins from 23 percent of sales revenue in 1991 to 18 percent in 1993.

The contribution margins (percentage mark-ups on total direct costs) were estimated to range from 11 to 21 percent for bottles and 13 to 40 percent for jars, according to a technical report commissioned by O-I. However, the current management at Jaroslaw did not have access to accurate cost of production data by different product lines. Rough estimates undertaken by Jaroslaw's management suggested that spirit bottles in long production runs were the most profitable, while trial runs for small jars were the least profitable.

Plant Operations

All of Jaroslaw's production activities were carried out at one plant site. The main building housed four furnaces, 15 forming machines, packing equipment and storage space on a total of 20,093 sq.m. Its capacity was estimated to be sufficient to run all four furnaces at maximum output. The company also owned an additional 25,223 sq.m. of adjacent land which was used for other activities such as loading and storage of raw materials and finished goods.

Jaroslaw was running at full capacity on 24-hour shifts, producing over 800 tons of products per day. Rough estimates from management indicated that the monthly breakeven could be achieved at 50-55 million units, a level which had been reached in the last six months of 1993. Thirty-two percent of total manufacturing costs were materials, 25 percent energy, and 15 percent labor in the first half of 1993 (Exhibit 12). The percentage costs of materials and supplies and energy were very high compared to those in Western European plants, while the percentage cost of labor was much lower.

Machine/Equipment Issues and Investment Needs

All four furnaces were built in the 1970s and were fueled by natural gas. According to industry norms, the furnaces operated continuously because the cost of turning them off and restarting them was prohibitively high. Furnace design was dated, giving them a useful life of five years compared to the modern standards of ten years. Fuel utilization was 30 percent higher than modern practices. Furnace output was only 60 percent of modern furnaces. Improvements in fuel utilization, output, and the useful life of the furnaces could be achieved with the reconstruction of them under modern designs. According to the repair schedule, one furnace would reach the end of its useful life every year starting end of 1994 and would need to be rebuilt. To rebuild the furnaces would take three months each and was estimated to cost $7 million per furnace.

Fifteen forming machines were connected to the furnaces. Molten glass was loaded from the furnaces to the forming machines in which it was molded and blown into containers. All of the existing forming machines were imported but only five of them were equipped with computer-controlled timing for the molding and blowing processes. Since the facilities were outdated, their design could not accommodate speedy changes in product types and sizes. Modifications in the forming lines and molding operations to adjust to a particular product type could take up to 15 hours in the Jaroslaw plant, compared to under one hour in other O-I plants. Jaroslaw had undertaken over a hundred production runs for different product types in 1993, each of which entailed high fixed costs in terms of equipment adjustment. Management observed that long production runs (of over 10 million units) had been very profitable while production run of under 500,000 units had resulted in losses several times in 1993.

The outdated designs of the production equipment also meant that Jaroslaw had limited capability in satisfying customer specifications in bottle design. Considerable amount of capital investment would be necessary to enhance the flexibility and capability of the production facilities to meet increasing demands for customer specifications, varied product mix, and short production runs. Management estimated the investment in new molding equipment to be around $4.5 million over three years.

The "cold end" of the production lines included the inspection, decorating and packing facilities. The inspection line consisted of a conveyor belt which brought finished products from the lehr to be inspected manually and automatically. Products that did not pass inspection would be rejected and deposited onto another belt which took them to be crushed and deposited back in the furnaces. The quality control process in Jaroslaw was viewed as outdated and below the standards of other O-I plants, especially since product quality and customer satisfaction were not familiar concepts on the factory floor. O-I technicians believed that the inspection process could be improved with the installation of Statistical Process Control (SPC) system, under which the quality of finished products to be inspected would be statistically controlled. Overall, the layout of the cold end of the production lines, including the decorating and packing facilities, could be modified to improve quality control and production efficiency by 15 percent. Modifications required in the cold end of the production lines were estimated to be around $2.5 million over three years.

Environmental Status of the Plant

As a leader of container glass production technology worldwide, O-I prided itself as an environmentally-friendly company. In addition, the European Bank for Reconstruction and

Development had placed stringent requirements on environmental improvements as part of conditionality of the term loan. Thus, Jaroslaw was expected to put high priority on environmental management areas in the near future. The principal environmental issues associated with Jaroslaw's production were related to air, water and noise pollution.

The main sources of energy for the production process were natural gas and electricity. Energy usage per unit output in the Jaroslaw plant was high by Western standards. The emissions of nitrogen oxide by the Jaroslaw plant to the atmosphere exceeded the level allowed under Poland's new stringent environmental standards. Emissions could be reduced to a level in compliance with the Polish law by replacing the existing furnaces with more advanced models. The increased use of recycled glass as raw materials would also reduce energy consumption and gas emission.[5] Jaroslaw's management had obtained exemptions from the environmental authorities for 1994 based on its plans to replace the furnaces over the next few years.

Water pollution associated with the production process was also a concern. The emission of oil-based effluent to the river brought over $13,000 in fees and fines to Jaroslaw in 1993. Waste water emission could also potentially tarnish the image of the Jaroslaw plant in the community. Total water recycling technology was available and had been utilized in other O-I plants. The construction of a new water treatment plant was estimated to cost $400,000.

The production process also produced a considerable amount of noise pollution, primarily from the furnaces and forming machines. This problem affected mainly the workers on the factory floor and could be greatly diminished with the proper usage of ear plugs in the high volume areas.

Personnel Redundancies

Jaroslaw employed 1,403 workers as of January 1994 (Exhibit 13), compared to 490 workers employed in another O-I plant in United Kingdom with similar production capacity. In 1993, salaries and wages amounted to approximately 15 percent of operating costs, which was low compared to the 35 percent in other Western Europe plants. Salary levels in Jaroslaw were only 10 percent that of plants in Western Europe.

The new managers from Owens-Illinois were anticipating some layoffs after the expiration of the 18-month employment guarantee. The bulk of the redundancies would be focused on personnel who managed social assets, many of which were to be divested by the company. These social

In glass manufacturing, melting recycled glass required 15 percent less energy than melting raw sand. Under existing industry technology, the proportion of raw materials mix could be reduced to 10 percent raw sand and 90 percent recycled glass.

assets included health care facilities, a subsidized apartment building, a canteen, and a number of recreational facilities. Management of the social assets had consumed a considerable amount of management resources which could be devoted instead to improving marketing and production operations.

In addition, the company intended to spin off several services which could be more efficiently delivered under contractual agreement such as property maintenance, gardening, electrical repair work, etc. Some staff reduction would also result from increasing automation in the production process. O-I estimated redundancies to be around 400-450. The company hoped to achieve as much of this reduction as possible through natural attrition and voluntary separation. Turnover rates in the plant had been around 10-12 percent per year.

Three main trade unions were active at the plant, with a total membership of over 800. The largest was Solidarity, followed by the Jaroslaw Workers' Union and the Engineers' & Technicians' Union. The unions had been supportive of the privatization process. Although the management role of the workers was officially terminated in October 1991 with the dissolution of the Workers' Council, the unions were still a powerful force to be reckoned with by the new management. For instance, the workers' dissatisfaction with Heye and their overwhelming preference for O-I were instrumental to MOP's final decision on the strategic investor.

Thus far the workers had maintained a positive impression of O-I. The workers understood that the capital infusion brought by O-I and its financial partners essentially brought Jaroslaw's out of its precarious financial condition. The morale of the workforce was significantly higher than 12 months ago. Both the old management and the workers were looking forward to working under a new environment. However, Adam Kowalski detected some degree of anxiety among employees due to the uncertainty regarding the level of redundancies and the severance.

The Jaroslaw glass plant was considered one of the major employers in the area. Unemployment in the area was estimated to be around 16-20 percent in January 1994. Only a minority of Jaroslaw's workers owned farm lands which could provide an alternative source of income. Most did not have the capital or the experience to start up new businesses.

O-I's Jones, who had extensive experience dealing with unions and labor issues in the United Kingdom, worked to implement a retrenchment process which would maintain morale, loyalty and the productivity of the workforce. The challenge was to devise a retrenchment strategy which would not jeopardize the existing cordial relationship between management and labor.

Jaroslaw's Accounting Procedures

Standard Polish central accounting reporting procedures were in place in Jaroslaw, administered by the Economics Department. Jaroslaw's existing accounting system was not fully compatible with that of O-I. It also did not lend itself to detailed analysis of the company's cost structure, particularly by individual product. The accounting system in Jaroslaw had been operated manually.

Working Conditions and Morale of Workers

Existing safety measures on the factory floor were not satisfactory compared to standards in Western Europe and North America. Kowalski observed that the use of protective eye glasses, ear plugs and other protective devises were practically nonexistent. Broken glass which was removed from the production lines by the workers was often scattered on the factory floor. He also noticed poor overall upkeep of and some vandalism on the factory premises. Adam believed that the low safety standards and the factory appearance both reflected and contributed to low morale among the workers.

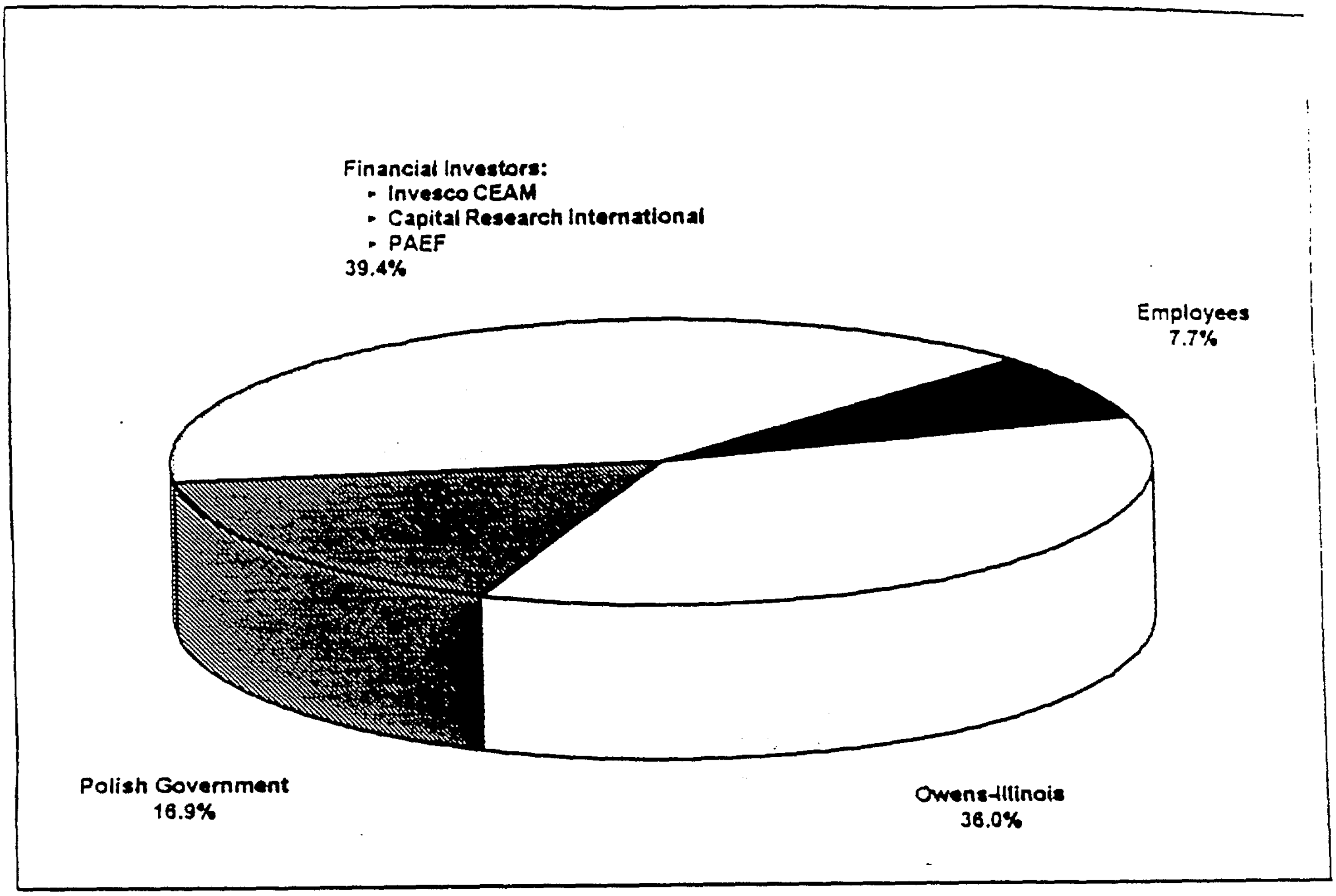
The Decision

While O-I's senior management had made initial plans related to capital investment and financing, decisions in the areas of POM reorganization, personnel retrenchment and market strategy would be best left with the new Managing Director, once he had developed a better understanding of the company. The challenge of Kowalski now was to help Jones prioritize actions in each of these areas while balancing of the company's needs and employee concerns.

Exhibit 1

HUTA SZKLA JAROSLAW S.A.

OWNERSHIP STRUCTURE AS OF DECEMBER 20, 1993



Source: HS Jaroslaw S.A.

Exhibit 2

HUTA SZKLA JAROSLAW S.A.

PROFIT & LOSS STATEMENT
YEAR END 1993
(All figures in Zloty millions)*

Sales Revenues	809,893
Sales Tax	(47,744)
Net Revenues	762,149
Operating Costs	(623,130)
Operating Profit	139,019
Financial Incomes	6,837
Financial Expenses	(16,321)
Interests Received	0
Interests Paid	(42,192)
Other Income	2,705
Other Expenses	(2,783)
Extraordinary Gains	3,819
Extraordinary Losses	(40,281)
Earnings Before Taxes	50,803
Income Tax	(29,020)
Dividend	(4,500)
Excess Wages Tax	(14,609)
Net Income	2,674

Source: HS Jaroslaw S.A. (F-01)

* The average exchange rate in 1993 was Zl. 18,115 to one USD.

HUTA SZKLA JAROSLAW S.A.

BALANCE SHEET
(All figures in Zloty millions)*

ASSETS	01/01/93	12/31/93
Fixed Assets	305,604	288,103
Inventory:		
Finished Goods	30,872	33,962
Raw Materials	41,843	54,091
Work in Progress	493	1,139
Other	1,073	686
Total inventory	74,281	89,878
Accounts Receivable:		
Domestic Trade	89,333	115,735
Export	14,418	16,041
Other	9,217	22,558
Total A/R	112,968	154,334
Cash & Equivalents	936	127,618
Total Current Assets	118,185	371,830
Other Assets	74,448	44,760
Total Assets	568,237	704,693

Source: HS Jaroslaw S.A. (F-02)

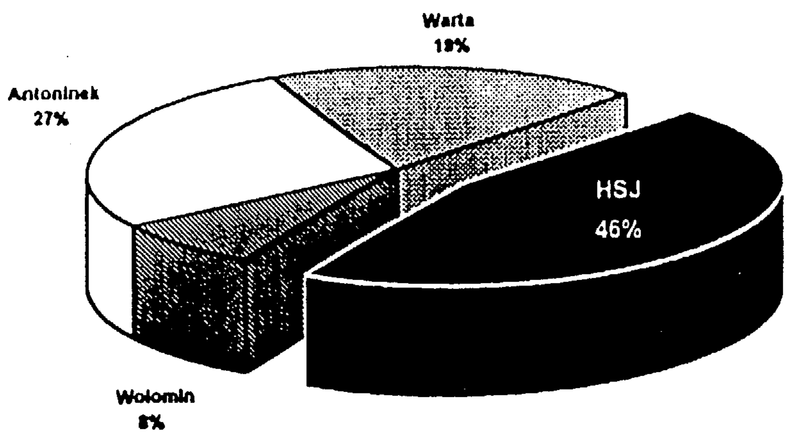
* The exchange rates were:
  01/01/93: 1$ = 15,767zl
  12/31/93: 1$ = 21,344zl

LIABILITIES & EQUITY	01/01/93	12/31/93
Short Term Debt	67,918	20,490
Accounts Payable:		
Domestic Trade	85,625	37,705
Foreign	64,457	1,584
Other	49,273	19,403
Total A/P	199,355	58,692
Total Current Liabilities	267,273	79,182
Other Liabilities	9,129	36,059
Provisions	22,135	49,713
Long Term Debt	16,240	0
Total Liabilities	314,777	164,954
Equity:		
Share Capital	224,557	537,065
Retained Earnings	28,903	2,674
Total Equity	253,460	539,739
Total Liabilities & Equity	568,237	704,693

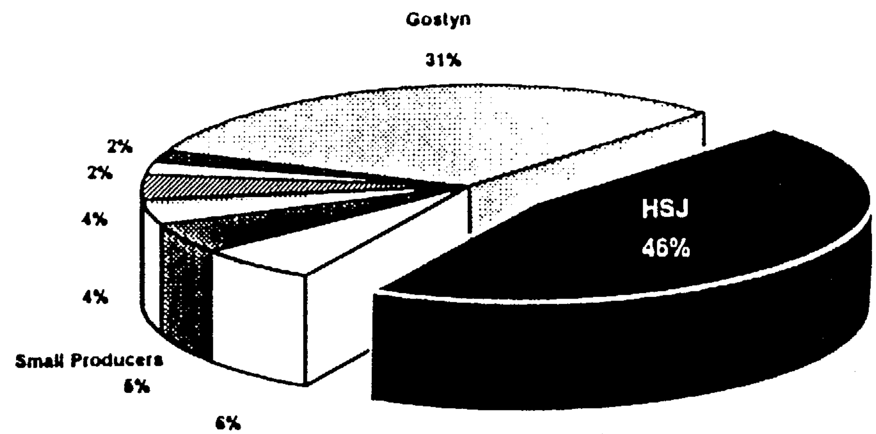
Exhibit 4

HUTA SZKLA JAROSLAW S.A.
1993 MARKET SHARES
(in number of units)

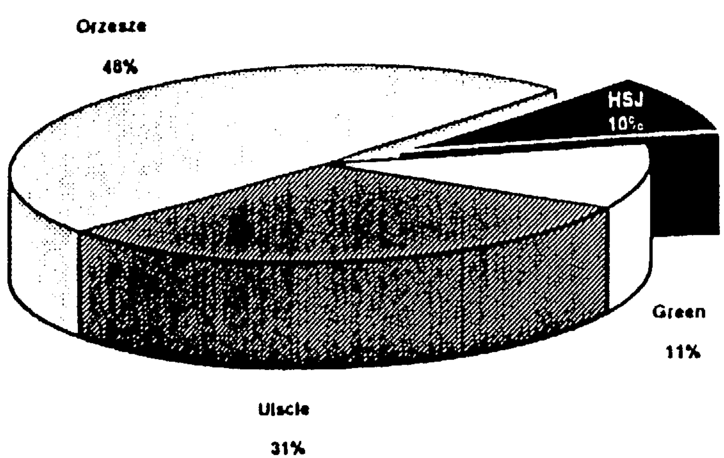
SOFT DRINKS
260 million



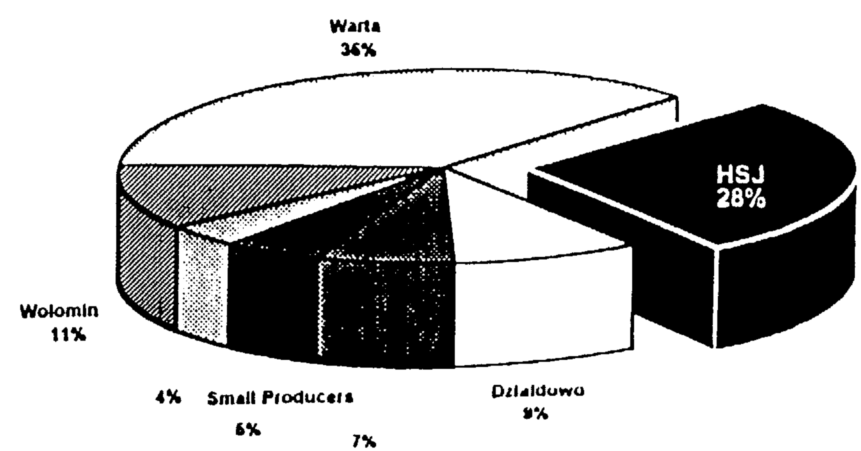
FOODS
783 million



BEERS
132 million



FLINT SPIRITS
404 million



Source: The Center for Consultancy

Exhibit 5

HUTA SZKLA JAROSLAW S.A.

EXPORT OF JAROSLAW AND MAJOR COMPETITOR

Summary of Exports*		1991	1992	1993**
Amber Bottles	HSJ	138	141	120
	Ujscie	60	46	48
		198	187	168
Flint Bottles	Warta	51	26	29
	Wolomin	-	45	-
		51	71	29
Flint Jars	HSJ	87	56	16
	Gostyn	131	76	33
		218	132	49
TOTAL		467	390	246

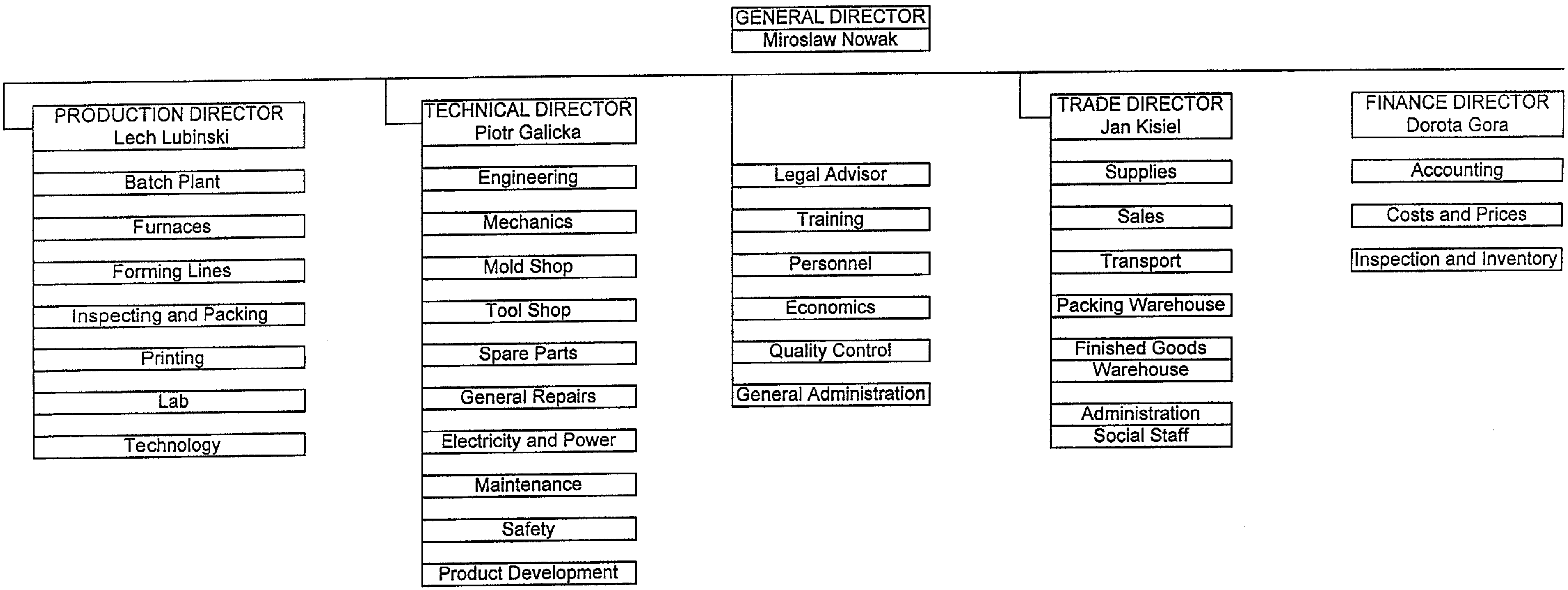
* Million of Units

** Estimates

Sources: Trade sources; Center for Consultancy

Exhibit

HUTA SZKLA JAROSLAW S.A.
ORGANIZATION CHART



Source: HS Jaroslaw S.A.

Exhibit 7

MANAGEMENT BOARD

HUTA SZKLA JAROSLAW S.A.

October 1993

Miroslaw Nowak Director and Chairman of the Board of Directors. He earned his college degree from the Higher School of Economics in Poznan, and worked for Ujscie Glassworks before transferring to Jaroslaw in 1975. He occupied the position of Deputy Finance Manager and Chief Accountant until July, 1990, when he was appointed Acting General Director. Following the transformation of the enterprise into a joint-stock company, he became Chairman of the Board of Directors of HS Jaroslaw S.A. He stepped down as General Director in July 1993. Age: 48 years.

Lech Lubinski Director of Production. He earned his degree in mechanical engineering from Rzeszow Technical University. He started working for Jaroslaw in 1974 in the Production Department, where he has held a number of different positions leading to his appointment as Deputy Production Director in July, 1991. Age: 42 years.

Jan Kisiel Director of Trade. He earned his college degree in economics and foreign trade from the University of Lodz. He has worked as the sales manager for several other companies, and was employed by Jaroslaw in 1985 as Deputy Director of Trade. Age: 41 years.

Dorota Gora Finance Director. She graduated from the Industrial Economics Department at Maria Curie-Sklodowska University in Lublin. In 1977, she became a Chartered Accountant. During her professional career she has held a number of finance and accounting positions at various companies. She has worked at Jaroslaw for 20 years, holding positions in the cost and accounting departments. She has been Financial Comptroller since February 1991. Age: 48 years.

Piotr Galicka Technical Director. He earned his degree from Rzeszów Technical University. He started working for Jaroslaw in 1971 and was promoted to Technical Director in 1991. Age: 49 years.

Source: HS Jaroslaw S.A.

Exhibit 8

HUTA SZKLA JAROSLAW S.A.

COMPOSITION OF SUPERVISORY BOARD
December 1993

Joseph Underhill (Chairman)	-	Owens-Illinois
Bill P. Scott	-	Owens-Illinois
George L. Brown	-	Owens-Illinois
Janusz Z. Brodowski	-	Sołtysiński, Kawecki i Szajkowski (O-I's legal representative in Poland)
Richard B. Holland	-	Polish-American Enterprise Fund
Darek Konina	-	Polish-American Enterprise Fund
Anna Wera	-	Ministry of Privatization

Source: HS Jaroslaw S.A.

Exhibit 9

HUTA SZKLA JAROSLAW S.A.

BIOGRAPHIES OF NEW EXPATRIATE DIRECTORS

Montgomery Jones Before transferring to Jaroslaw as the Managing Director, Mr. Jones was the Manufacturing and Technical Director at United Glass Limited, an O-I subsidiary in the United Kingdom, in which he has served since 1965. Mr. Jones has extensive experience dealing with personnel, management, and technical issues, having occupied various management positions in United Glass including Personnel Manager, Group Salary Administration Manager, Manpower Manager, Manufacturing and Personnel Director, and Manufacturing and Technical Director. Age: 47 years.

Gregory Smith Prior to joining HS Jaroslaw as the new Director of Finance, Mr. Smith was the Administrative Manager/Comptroller at Owens-Brockway Glass company in the United States. During his 19-year career with Owens-Illinois, Mr. Smith has served as a Cost Analyst, Comptroller, Cost Control Supervisor, and Administrative Manager at various O-I plants in Oregon, Ohio, Virginia, Illinois, and Pennsylvania. Age: 51.

Source: HS Jaroslaw S.A.

Exhibit 10

HUTA SZKLA JAROSLAW S.A.
SALES

Million Units	1991		1992		1993 Estimates		Change 1993 over '91/92 average
Bottles:							
Beer	145	21%	144	21%	133	17%	(8%)
Wines & Spirits	70	10%	48	7%	112	14%	90%
Soft Drinks	238	35%	204	30%	155	20%	(30%)
Total	453	66%	396	58%	400	51%	(6%)
Jars:							
Foods	230	34%	284	42%	380	49%	48%
TOTAL	683	100%	680	100%	780	100%	14%

Value, ZL.Bn	1991		1992		1993 Estimates		Change 1993 over '91/92 average
Bottles:							
Beer	93	21%	123	21%	116	14%	8%
Wines & Spirits	84	19%	75	13%	200	24%	152%
Soft Drinks	131	29%	187	33%	156	19%	(2%)
Total	308	69%	385	67%	472	57%	36%
Jars:							
Foods	141	31%	189	33%	356	43%	116%
TOTAL	449	100%	574	100%	828	100%	62%

Source: HS Jaroslaw S.A., The Centre for Consultancy

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HUTA SZKLA JAROSLAW S.A.

AVERAGE SELLING PRICES FOR JAROSLAW'S PRODUCTS

US $ per 100		1991	1992	1993 Est.
Bottles				
	Beer	6.06	6.27	4.63
	Wines & Spirits	11.31	11.50	9.26
	Soft Drinks	5.20	6.72	5.20
	Total	6.42	7.13	6.12
Jars				
	Foods	5.80	4.88	4.86
TOTAL		6.21	6.19	5.50
Average Exchange Rate of Zlotys per US$		10,576	13,627	16,550

* The use of average exchange rates may not capture the fluctuations of the Zloty against the dollar for particular sales during this period

Source: The Centre for Consultancy

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Exhibit 12

HUTA SZKLA JAROSLAW S.A.

MANUFACTURING COST BREAKDOWN
FIRST HALF OF 1993
(in Zloty millions)*

	JAROSLAW		Typical O-I Plant
	first 6 months 1993	% of total	% of total
Raw Materials	59,263	21.1	12
Packing	18,791	6.7	6
Moulds	8,278	2.9	-
Other	2,950	-	-
Total materials	89,282	31.7	18
Gas	52,290	18.6	-
Electricity	15,212	5.4	-
Water	1,058	-	-
Heating	1,655	-	-
Total energy	70,215	24.9	17
Labour Cost	44,158	15.7	35
Maintenance	16,910	6	3
Depreciation	16,021	5.7	10
Transportation	31,076	11	17
Overhead	13,862	4.9	
TOTAL	281,524	100	100

Source: The Centre for Consultancy

* The average exchange rate for the first 6 months of 1993 was Zl. 16,553 to one US Dollar

Exhibit 13

HUTA SZKLA JAROSLAW S.A.

CURRENT STAFFING LEVEL BY DEPARTMENT

DEPARTMENT	NUMBER OF EMPLOYEES
PRODUCTION	521
BATCH & FURNACE	103
PLANT ENGINEERING	187
MOLD & MACHINE	200
ELECTRONICS	44
DECORATING	27
FINANCE	75
PERSONNEL	136
SALES	110
TOTAL:	1,403

Source: HS Jaroslaw S.A.

HUTA SZKLA JAROSLAW S.A. (B)

POLAND

Upon his arrival, the new Managing Director quickly planned and implemented restructuring strategies to adapt the privatized company to a new operating environment. The new objectives of the company would be to increase sales, production efficiency, and profitability. Mr. Jones has placed a new priority on Jaroslaw's marketing operations to exploit opportunities offered by the new environment, based on a thorough assessment of Jaroslaw's competitive advantage. He then set out to identify investment priorities in the production operations, aimed at increasing efficiency and enhancing the capability to meet customer needs. Mr. Jones also focused on labor issues and adopted approaches aimed at balancing management's cost-reduction objective with workers' needs and concerns.

Market Strategy

In the marketing area, management's new emphasis was to create new markets and actively pursue sales. With the collapse of the former eastern bloc markets, newly privatized companies like Jaroslaw needed to identify new markets and proactively cultivate a new client base and marketing arrangements for their products. Given the growing opportunities in Poland and in her neighboring countries, several strategic marketing directions would be pursued by Jaroslaw.

Focusing on Domestic Market

Management decided that the ideal market mix for Jaroslaw would be 80 percent in domestic sales and 20 percent in export sales. Jaroslaw had already established a good reputation for price and quality in Poland, which would provide it with a solid foundation for sales expansion. The Polish market had good growth potential over the short and medium term, given the overall economic prospects and the projected growth in glass container usage.

Selectively Expanding Exports

Jaroslaw would also pursue sales in selected export markets. Exports helped diversify market risks and fill unused capacity, particularly during seasonal slowdowns in Poland's beer and soft drink consumption during winter months. Jaroslaw would most likely retain its current relationship with several German customers. Overall, the EU market was extremely price-sensitive and was viewed as geographically remote for Jaroslaw to be competitive. However, the management saw increasing opportunities to expand selectively in the emerging neighboring states of Ukraine, Slovakia, Russia etc. Jaroslaw was also positioned to expand indirect sales to those regions through food producers based in Poland.

Improving Quality and Increasing Publicity

Another important marketing direction was to build on Jaroslaw's existing reputation as a high quality domestic producer to promote brand loyalty among customers, especially in the high end of the market. The Sales and Marketing Department would focus on improving the image and increasing visibility for Jaroslaw's products. Visibility would be raised by more frequent use of the Jaroslaw logo on products, cartons and delivery trucks. The Sales and Marketing Department would also place a new emphasis on achieving customer satisfaction through better quality products, higher capacity in meeting customer specifications, and improved customer service. Customer satisfaction was viewed by new management as key to repeat business for Jaroslaw.

By May 1994, the implementation of Jaroslaw's new market strategy was well underway, as reflected in the new attitude and new focus of Jaroslaw's workers and management on product quality and client satisfaction. The Sales and Marketing Department also has been successful in generation additional sales. Production reached record volumes in the first quarter of 1994, and was 20 percent higher than the first quarter of 1993.

Management Reorganization

To rationalize Jaroslaw's management structure and adapt it to the new operating objectives of increasing sales, production efficiency and profitability, the Management Board was reorganized (Exhibit 1). Many of the former Management Board directors were retained, some reappointed to new positions where they would be expected to contribute in their areas of expertise. The major organizational changes included:

Reorganization of Sales Operations

The former function of Trade, which used to include purchasing, social administration, sales, and marketing was reorganized to reflect the new priority of creating markets and active sales promotion. A new Export Sales unit was created. To ensure that the Sales and Marketing Department focus on expanding sales, activities such as Supplies and Administration of Social Staff were transferred to other departments. The former Deputy Director of Trade, Mr. Kisel, was reappointed as the Sales and Marketing Director due to his extensive client contacts and his experience in developing new markets for Jaroslaw.

Strengthening Financial Operations and Controls

The responsibilities of Mr. Gregory Smith, as the Finance Director, included general financial planning and controls, as well as financing arrangements for the capital investment plan and establishing a new financial and cost accounting system at Jaroslaw. Ms. Dorota Gora, who was replaced by Mr. Smith, retained most of her former accounting and financial management responsibilities in the position of Financial Comptroller and as the Deputy to the finance Director. The Purchasing Department and the Legal Counsel were also placed under the Finance Director.

Prioritizing Personnel Issues

To reflect management's priority in addressing personnel issues, a new position - Personnel Director - was created in the Management Board. Mr. Nowak, formerly the General Director of Jaroslaw, was appointed as the Personnel Director. Mr. Nowak was seen as especially qualified due to his good relations with the unions. Mr. Nowak would be instrumental in working with union representatives in the process of labor retrenchment. Aside from personnel issues, Mr. Nowak would also supervise the Quality Manager, Environmental Specialist, and the Safety and Hygiene Manager. These functions were placed under the Personnel Director primarily because of the extensive experience of Mr. Nowak in these areas when he served as the Managing Director of the company.

Management reorganization proceeded quite smoothly, as none of the previous directors were dismissed and all were assigned to roles to which they were believed to have the most expertise. The challenge for the expatriate managers, in the short to medium term, was to better integrate the expatriate management with local management and overcome barriers such as operating in different languages and corporate cultures.

Capital Investment and Financial Plan

In early 1994, Jaroslaw's management implemented a capital investment and financial plan, designed to satisfy three objectives: (1) reducing cost and enhancing productivity; (2) improving product quality; and (3) making the production process more environment-friendly. Major investments were planned in the following areas:

- All four furnaces would be rebuilt between 1994 and 1998 based on the latest design. This was expected to double their life expectancies, increase their melting capacity, reduce their energy consumption by 30 percent, and diminish the level of nitrogen oxide emission to meet current Polish environmental standards.

- Jaroslaw can take advantage of O-I's industry knowledge and tap into its technical expertise through licensing agreements and training arrangements to improve its production operations and skill levels of its labor force.

- Jaroslaw, as an affiliate of O-I, is now in a better position to obtain new loans for capital investment based on O-I's established international reputation and credibility.

- Jaroslaw could benefit from the management expertise that O-I had accumulated, especially through the expatriate managers transferred from other established O-I plants.

- Jaroslaw can take advantage of O-I's existing marketing networks worldwide, particularly its strategic alliance with Alima Gerber.

The existing Polish managers can make major contribution in the following areas:

- Experience in dealing with unions and in motivating workers in the particular setting of the Jaroslaw plant;

- An understanding of the labor issues and concerns in the particular context of Poland, which is especially important in formulating strategies for retrenchment and in treating social assets; and

- continuing relationship with existing client base and knowledge of the emerging market opportunities in Poland.

8. <u>Of the challenges facing Jaroslaw, which ones do you think would be typically experienced by other private companies, and which ones are particular to the restructuring of privatized SOEs, especially in the Polish context?</u>

The question is intended to help students identify the particular challenges facing privatized SOEs and distinguish them from those facing all enterprises operating in a market environment. This question is important because it is in those areas where the strict application of conventional business principles may be inappropriate, and where local managers can have the most useful input in crafting innovative solutions.

The restructuring challenges typically shared by many other private companies undergoing restructuring would include financial restructuring, labor downsizing, and market development strategies. For a recently privatized enterprise in the Polish setting, several additional challenges will be posed:

- There is a more pressing need to identify new markets due to the disintegration of previous customer base and market arrangements. In addition, the marketing and sales department are usually underdeveloped and staffed with individuals inexperienced with modern marketing techniques.

- The procurement practices may need major overhaul to emphasize price, quality, delivery and services of the suppliers. The concept of competitive bidding among vendors often has to be introduced as a cost-reduction measure.

- The salary structure may have to be changed such that it will be based solely on performance and not on seniority and other factors in the future.

- Privatized enterprises in a former communist country may also face additional challenges in the area of labor retrenchment. First, workers often are not accustomed to lay-offs and may see it as a major violation of their social rights. Second, the underdevelopment of social safety nets in former communist countries will tend to aggravate the negative impact of labor retrenchment and the spinning off of social assets. Third, the private sector in those economies may not present sufficient alternative employment opportunities for retrenched workers.

- In Poland, in particular, the strong tradition of labor unions means that union will be a player to be reckoned with in the restructuring decisions which have direct impact on labor include wages, retrenchment, social assets issues.

- To improve the quality of Jaroslaw's products, new forming machines and molding equipment would be purchased to increase the capability and efficiency in meeting clients' product specifications. Statistical Process Control (SPC) and new inspection equipment would be introduced to improve the process of defect detection.

- New computerized equipment would be introduced to enhance the automation and control of the production process.

- A water treatment plant would be constructed in 1994 to achieve zero contaminated water discharge.

- New telecommunications equipment would be purchased to improve communications with the O-I headquarters and Jaroslaw's clients.

- The financial accounting and cost control systems would be computerized to facilitate more effective cost control and more accurate product pricing.

In view of the ambitious investment plan, approximately $30 million would be invested in 1994-95 to rebuild two furnaces and to upgrade Jaroslaw's existing equipment. Jaroslaw's management were confident that immediate productivity gains would be achieved by the new investment. For example, fuel consumption (mainly natural gas) in the rebuilt furnace would be reduced by 30 percent, which could be translated into savings of over $470,000 per year. Furnace output could be raised by over 90 percent, potentially bringing $6.7 million in increased revenue.

Over the next seven years (to year 2001) an additional $30 million could be invested, 90 percent of which would be in production equipment (including the furnaces) and environmental equipment. Upgrading of telecommunications systems and computerization was expected to fall in the range of $1-2 million.

The capital investment plan was also designed to meet management's objective of bringing Jaroslaw into full compliance with Polish environmental regulations over the next five years. In addition to reducing energy consumption, the replace of old furnaces would also reduce the emission of nitrogen dioxide to the level allowed by the Polish environmental authorities. Since the four furnaces would be replaced over the next four years, management had obtained a five-year dispensation from the authorities while the existing furnaces reached the end of their useful lives.

A zero-discharge water treatment plant would be built in 1994 and immediately bring Jaroslaw into compliance with current water discharge regulations. It would also improve Jaroslaw's image in the community and with the Polish environmental authorities.

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Management planned to finance part of the capital investment from operating profit. However, the majority of the funds would be provided by a syndicate of international commercial banks led by the European Bank of Reconstruction and Development (EBRD). O-I Poland has obtained an initial commitment from EBRD and its consortium for up to $43 million. The long term capital loan would be made in dollars, while the working capital loan would be in Zloty, both at market rates. The repayment of principal would not begin until 1996-97. To guarantee its healthy cash position during the restructuring process, Jaroslaw also obtained agreement with its financial investors on a five-year moratorium on dividend payments.

Personnel Strategy

By the second quarter of 1994, management began to actively implement a personnel plan reflecting the priorities and human resource needs under a new operating environment. Management estimated that in the new environment, the appropriate size of the labor force would around be 1,000, implying redundancies for about 400 employees. Redundancies would occur primarily in the following areas:

- On the factory floor, fewer workers would be required with increasing computerization and automation of the production and inspection processes.
- Outside of the production line, many services would be transferred from salaried employees to external contractors to reduce cost and increase flexibility and efficiency. Some of these services include gardening, property maintenance, electrical repair work, etc.
- Some of the administrators of the company's social assets would be made redundant as those assets were spun off or discontinued.

Retrenchment Strategy

While Jaroslaw was not legally bound by employment guarantees after March 1995, management would like to minimize the negative impact on those affected by the retrenchment process. It was also critical to maintain loyalty, morale and productivity among the employees who were retained as the effects of downsizing reverberated through the company. To achieve these objectives, the retrenchment process adopted by management bore the following characteristics:

- **Honesty, Openness and Consistency** During the lengthy negotiation process with the labor unions, management had been consistent in the level of redundancies and the compensation packages considered. The opinions and concerns of the labor unions were also actively solicited. As a result of honest and open communications, labor leaders were supportive of management in the retrenchment process.

- **Generosity and Flexibility** Management would offer a separation package that included lump sum payments and stock repurchasing options to maximize a one-time cash payment to those who opted for voluntary severance. An early retirement program would also be offered to render voluntary separation more attractive. Ample time would be given to workers to evaluate the severance package offered and to make optimal employment decisions.

- **Encouraging Alternative Employment Opportunities** In order to encourage voluntary separation and reduce the associated negative effects of dislocation, management had been working with the local Small Business Council to create new self-employment opportunities. Self-employment in Jaroslaw had been constrained mainly by the lack of credit, entrepreneurial experience and assured business. In service areas that would be spun off, the company could act as a steady client base, at least initially, to former employees who would like to provide services on a contractual basis. Small business credit and equipment leasing to former employees were also considered by management.

- **Gradual and Evolutionary Approach** The new management had adopted a gradual approach to retrenchment, a pace which facilitated the growth of familiarity and trust between labor and new management.

In the areas of social assets, management placed priority in disposing of those considered the heaviest drain on administrative time. These included the hotel and the apartment building.

Reforming the Working Environment

For the workers who were to be retained, management planned to introduce a new policy that would tie future salary increases to performance and no longer to seniority and other factors. Management also planned to improve the safety standards (mandatory use of ear plugs and protective eye glasses) and cleanliness of the work environment, as well as amenities such as restroom facilities and employee cafeteria. In addition, the company would introduce medical personnel on staff to provide prompt treatment to job-related injuries or illness.

As part of the reorganization process, the structure of the labor force would be changed to reflect the skills demanded in the new environment. With increasing computerization and automation of production operations, a more skilled workforce would be required. Engineers and technicians were sent to other O-I plants for training in equipment operation, adjustments and repairs. English courses were also given to facilitate the understanding of English language equipment manuals.

B Case - Exhibit 1

HUTA SZKLA JAROSŁAW S.A.

ORGANIZATION CHART

- **MALCOLM GRIFFIN** — Managing Director
  - **JACEK MIELCZAREK** — Management Advisor, Special Projects
  - **ADAM GAJEWSKI** — Sales & Marketing Director
    - ZYGMUNT LULA — Marketing Manager
    - WIESLAW TROJNAR — Sales Manager
    - PIOTR MICHALSKI — Export Sales Manager
    - LESLAW KULPA — Logistics Manager
  - **ZYGMUNT JAMINSKI** — Manufacturing & Technical Director
    - ANTONI SKARBEK — Batch & Furnace Manager
    - JERZY ZOLYNIAK — Production Manager
    - KAZIMIERZ CENA — Mold & Machine Engineering Manager
    - FRANCISZEK JUZWA — Electronics Engineering Manager
  - **WLODZIMIERZ RZASA** — Personnel Director
    - PIOTR NIEPRZECKI — Quality Manager
    - RENATA SZPUNAR — Personnel Manager
    - JANUSZ FRANCZYK — Environmental Specialist
    - WALDEMAR DABROWSKI — Safety & Hygiene Manager
  - **JAMES HATT** — Finance Director
    - ANNA KALAMARZ — Financial Comptroller
    - MARIAN KOWALCZYK — Purchasing Manager
    - MARIA RACZYNSKA — Administration Manager
    - MARIA GALICKA — Legal Counsel

Source: HS Jaroslaw S.A.

HUTA SZKLA "JAROSLAW" S.A.

POLAND

TECHNICAL NOTE

1. Poland's Privatization Program

a. Objectives

The privatization process in Poland is governed by the Act on the Privatization of State-Owned Enterprises, adopted by the Polish parliament in July 1990. The Act regulates the manner in which ownership of economic entities may be transferred from the state to the private sector. The Act also established the Ministry of Ownership Changes (or the Ministry of Privatization - MOP) and charged it with preparing guidelines for and carrying out the privatization process.

The ultimate goal of Poland's privatization program is to establish the foundation of an efficient economy by transforming the highly centralized, socialist system into a market-based system characterized by private ownership. The government wanted to achieve the process quickly and systematically, and as such adopted a set of guidelines and procedures to reach its goals under an ambitious timetable.

b. Techniques

State-owned enterprises can be privatized through one of two methods: (1) liquidation, in which the assets of unprofitable, small to medium-sized firms can be sold or leased to private investors or management and employees; and (2) transformation into a joint-stock company, also known as capital privatization. Initially owned by the State Treasury, a transformed company is autonomous and operates according to the provisions of the Commercial Code. A transformed company is then privatized through a public offering, trade sale, auction, or the Mass Privatization Program within a two-year period.

c. Accomplishments to Date

For larger Polish enterprises, MOP has initially adopted a sectoral approach to privatization. Under this approach, comprehensive analysis for important economic sectors has been conducted, on the basis of which restructuring and privatization policies for particular sectors have been developed. Companies in those sectors are then privatized through variations of the liquidation or transformation methods, based on sector-specific considerations. The sectoral approach has been utilized as a mechanism to organize MOP resources as well as the financial and technical assistance from the donor community.

As of the first quarter of 1994, approximately 2,000 Polish enterprises have been privatized, 110 of which were accomplished using the capital privatization method. The remaining were mostly small to medium-sized enterprises privatized through the liquidation method.

To accelerate the pace of privatization, in 1994 MOP will shift its focus from the sectoral approach to the Mass Privatization Program, under which the case-by-case method will give way to simultaneous privatization. Over 300 state-owned enterprises have initially been identified to participate in the Mass Privatization Program.

A predetermined ownership structure will be applied to firms privatized under the Mass Privatization Program. Ten percent of the total shareholding will be given free of charge to the workers, 30 percent will be retained by the State Treasury, and 60 percent will be distributed among ten National Investment Funds. At least one of the funds will hold a 21 percent share in a company and act as the "owner." As such, the investment funds are responsible for restructuring the firms in their portfolio to prepare them for public offering or direct sale to interested investors. These funds will be managed by experienced foreign fund managers. The program will be supported by the simultaneous development of the primary and secondary capital markets.

2. Results/Impact of the Jaroslaw Privatization

a. Employee Impact

The workers of Jaroslaw, who supported management in opting for capital transformation, have felt the impact of privatization on several levels.

(i) Employment Impact Since the share sale agreement signed by Owens-Illinois (O-I) guaranteed employment for 18 months, the workers have not felt the impact of retrenchment immediately. However, after the expiration of the guarantee, 400-450 workers are expected to be made redundant. Overall, the welfare impact on the retrenched workers will depend on the separation package offered by management, the alternative employment opportunities available, and the skill mobility of individual workers. While Jaroslaw was not a single company town, the Jaroslaw plant was one of the several larger employers in the area. The local unemployment rate as of January 1994 was estimated to be around 16-20 percent. The separation package which would be offered by O-I had not been determined at the time of the study.

(ii) Social Services and Other Benefits Under the new management, formerly benefits offered by the company such as subsidized apartment, vacation housing, and other recreational facilities are likely to be given away, spun off, or discontinued. The exact welfare loss to the workers will vary with their use of those services and benefits. For those employees occupying company-owned apartments, welfare loss will be minimal as those apartments will likely be given away for free. As for health care benefits, management has decided to continue operating a clinic to provide treatment mainly for minor illnesses or job-related injuries.

(iii) Management Rights and Responsibilities With the share sale to O-I and the financial investors, the management authority of Jaroslaw's Workers' Council was eliminated. Workers would no longer make management decisions with regard to the company's operations, finances or strategic directions. Instead, the unions would seek to influence labor-related management decisions through negotiations and collective bargaining with management within the private company framework.

(iv) Job Safety and Health Issues The workers' concern with the unsafe work conditions on the factory floor and the treatment of job-related health problems were taken into account by the new private owner. Stringent safety measures will be introduced in the factory, and a medical personnel will be employed to provide prompt, on-site treatment for on-the-job injuries. In addition, overall work conditions will be improved with the upgrading of amenities and employee facilities.

(v) Training As a result of privatization, Jaroslaw's workers will be retrained and their skills upgraded to respond to the need of operating more advanced, computerized and automated equipment.

(vi) Salary Increases Workers whose skills are upgraded and whose responsibilities are increased will be compensated with salary increases. In addition, future salary increases will be based solely on performance and not on seniority or other factors.

b.Revenue Impact on Government

In December 1993, the State Treasury received $3.15 million from Owens-Illinois for the purchase of 36 percent of Jaroslaw's shares. In late 1994, the Polish Government will receive an additional sum for the sale of 20 percent of Jaroslaw's shares to the employees. The shares will be sold to employees on preferential terms (at half the purchase price per share paid by O-I). Thus, the short term revenue impact on the Government will be approximately $4 million.

The remaining shares in Jaroslaw, equivalent to 44 percent of the outstanding share capital, were placed in escrow at the Polish Development Bank under a put and call option. The total price of the option shares, valued at $3.85 million in December 1993, will be sold to O-I and its financial partners within a 4-5 year period at the original price plus interest calculated at the 4-year U.S. Treasury rates. The total direct revenue impact is valued at $7.85 million in current U.S. dollar terms.

The privatization transaction will also have several indirect revenue impacts on the Government. The principal positive impact will be the increased corporate income tax revenue from a more profitable company. Although the magnitude of this impact cannot be calculated, initial indications suggest that the incremental tax inflows from higher profits could be significant. For instance, a 15 percent increase in profitability in Jaroslaw could bring an addition $240,000 in income tax receipts for the Polish Government in 1994.

In terms of personal income tax, the Government will benefit from higher receipts through salary increases, offset by reduced receipts from the workers who were laid-off. On balance, the personal income tax revenue impact is likely to be small since management anticipated a similar wage bill after retrenchment and salary adjustment.

c. Impact on Competitors

Prior to its privatization, Jaroslaw had already been recognized as one of the major players in the domestic glass sector on the basis of its price competitiveness and superior quality. Its acquisition by O-I, the industry giant and the leader in the glass manufacturing technology worldwide, is likely to consolidate Jaroslaw's position as the dominant manufacturer in the sector. The infusion of working capital brought by the transaction also significantly strengthened the company's financial position, making Jaroslaw a healthy and formidable competitor against other industry players.

It has been estimated by industry specialists that over the next few years, several of the smaller, unprofitable firms will be forced out of the increasingly competitive domestic market. The industry is likely to consolidate into several large players specialized in different glass container subsectors. Such a trend could be intensified with Jaroslaw's privatization and the strengthening of its market position, especially in several subsectors such as food jars and soft drinks. Jaroslaw's sale to O-I may also force other industry players to increase the quality of their products and upgrade their production technology to remain competitive in the market.

d. Impact on Suppliers

Jaroslaw's improved financial health resulting from its privatization is likely to benefit its suppliers in the form of continued orders and increased business volume. However, the new management of Jaroslaw has indicated that as a cost-reduction measure, they will be more demanding on their suppliers in terms of the quality, consistency, and price of the materials and services delivered. Management also plans to rely increasingly on competitive bids to select suppliers. The new approach will be introduced to bring Jaroslaw's purchasing practices closer to those of a profit-making company operating in a competitive market environment. Jaroslaw's new purchasing practices are expected to bring pressure on its suppliers to be more responsive to the needs and demands of their customers.

e. Impact on Customers/Clients

Jaroslaw's new management has placed a new emphasis on achieving client satisfaction through improved efforts to meet product specifications, higher quality products, and better after-sales customer service. This is very likely to have a positive impact on Jaroslaw's customers. Thus far, competition in the Polish glass container market has mainly focused on price and less on product quality and customer service. Generally, the quality requirements in the Polish market have been below western standards. Jaroslaw's new market strategy may stimulate other Polish producers to move in similar directions, raising the overall quality of the product and services delivered in the glass sector.

f. Financial Situation

The sale of Jaroslaw to Owens-Illinois in December 1993 has brought dramatic improvements to its financial position.

Jaroslaw entered 1993 with a serious cash-flow problem, reflected in its January 1, 1993 balance sheet in which current liabilities exceeded current assets by Zl. 79.1 billion ($5.3 million). Cash reserves were a meager Zl. 396 ($62,358).

Jaroslaw was essentially pushed to the brink of bankruptcy in February 1993 when Heye JV unexpectedly called its DM 6 million ($3.6 million) capital loan. Although its loan guarantor, BDK Lubline, paid off the loan on Jaroslaw's behalf, the interest and principal payments and other financial expenses amounted to Zl. 58.5 billion ($3.23 million) in 1993, aggravating Jaroslaw's financial situation since the beginning of 1993.

The sale of Jaroslaw to O-I and the issuance of new shares added $14.05 million in new cash and equity to Jaroslaw's balance sheet. The new paid-in capital has been used to settle short-term liabilities and pay off long-term debt. As of December 31, 1993, current assets exceeded current liabilities by Zl. 293 billion ($13.7 million). Cash reserves have been increased to Zl. 372 billion ($6 million).

With its strengthened financial position, Jaroslaw is set on a path to future growth and increased profitability. In addition to investing in productivity improvement, management will also push for more aggressive collection of receivables, implement cost reduction measures, and increase sales. New management has already seen profitability improvements in the first quarter of 1994, and it is expected that 1994 will be significantly more profitable than previous years.

g. Sales

O-I's alliance with Alima-Gerber as its exclusive glass container supplier worldwide has brought a stable customer base to Jaroslaw. Since the beginning of 1994, new orders have been increasing from the nearby Rzeszow plant owned by Alima Gerber. A new and more customer-oriented sales and marketing approach also brought additional sales. Jaroslaw's management estimated that sales in the first quarter of 1994 were 20 percent higher than in the corresponding period in 1993.

h. Changing Corporate Governance Structure of Jaroslaw

As a state-owned enterprise, Jaroslaw was headed by a Managing Director appointed by the Polish Government, who managed the company under the supervision of an elected Workers' Council. Upon transformation into a joint-stock company in September 1992, the Workers' Council was dissolved and its functions were replaced by the Supervisory Board. Of the nine members of the Supervisory Board, three were elected by the workers and six were appointed by the MOP.

After the share sale to O-I and the simultaneous increase in share capital, a General Assembly of shareholders was held during which the composition of the Supervisory Board was changed to reflect the changes in share ownership. In accordance with the Polish Commercial Code, the General Assembly of shareholders is the highest authority of the company and should convene at least annually. The principal powers of the General Assembly include the rights to examine the balance sheet and the profit and loss statement, to vote on the allocation of profits, and to appoint members of the Supervisory Board. The Company Charter delegates to the Supervisory Board the authority to appoint and dismiss members of the Management Board, and the responsibility to supervise the activities of the Management Board in the shareholders' interest.

As a result of privatization, several changes occurred in the corporate structure of Jaroslaw which would have implications on the corporate governance of the company.

<u>Insiders Versus Outsiders on the Board</u> Upon Jaroslaw's transformation into a joint-stock company, the company operated in accordance with the Polish Commercial Code, which stipulates that members of the Supervisory Board cannot simultaneously sit on the Management Board. This requirement is aimed at preventing conflicts of interests between the roles of the supervisors and those under supervision. Members of the Supervisory Board are elected to three-year terms and Board meetings are held quarterly.

Elimination of Workers' Supervisory Power With privatization and the issuance of new shares by O-I, the percentage of shares reserved for workers was reduced to 7.7 percent. Their small representation will likely prevent them from electing their own representatives to the Supervisory Board (14.3 percent of votes are required to elect one seat to the Board). As such Jaroslaw's workers will no longer have the legal authority to supervise the company's management.

Board Composition and O-I's Dominance A seven-member Supervisory Board was elected by the new owners of Jaroslaw to represent their interest. Since the majority of Jaroslaw's shares are not owned by individual shareholders, but by companies and financial institutions, the Board is composed of representatives from these institutions. However, the Board composition does not exactly reflect Jaroslaw's share ownership, as O-I, which holds only 36 percent of the total shares, has four out of seven seats in the Board. The financial investors, which together own close to 40 percent of the shares, are represented by only two members, both from the Polish American Enterprise Fund (PAEF). A seventh member is from the Ministry of Privatization.

The new owners agreed to the above Board structure because O-I is viewed as the strategic investor which has the industry expertise to manage Jaroslaw's operations efficiently. There is also an understanding that O-I would like to become a majority shareholder or sole owner of Jaroslaw in the long term. Thus, the financial investors are expected to take a less active role than O-I in supervising the company's management. With four seats on the Board, the senior management of O-I is expected to influence corporate decision-making at the company. However, there have also been indications from the first Board meeting that the financial investors would also like to take an active supervisory role, especially in the financial management of the company.

i. Environment

Jaroslaw's privatization is likely to have a positive environmental impact for three principal reasons: (1) the image and the technical capabilities of the international investor; (2) the more stringent environmental standards imposed by international financial institutions; and (3) the availability of new capital to invest in environmentally-friendly production technology and equipment.

Jaroslaw's new owner, Owens-Illinois, has acquired a reputation as an environmentally-friendly producer. As a company policy, O-I management would like to extend its image to all its subsidiaries, including Jaroslaw. Thus, management has indicated that environmental friendliness will be a major priority for Jaroslaw. As a subsidiary of O-I, Jaroslaw will benefit from the transfer of more modern, environmentally-friendly production technology developed by O-I.

In addition, the European Bank of Reconstruction and Development (EBRD) has imposed very stringent environmental standards on Jaroslaw as a conditionality of a term loan. Those conditions have been reflected in the priorities of Jaroslaw's capital investment plan.

Prior to its privatization, Jaroslaw had not been able to meet Poland's environmental standards due to the lack of investment capital. While the emission of gas and liquid wastes could be significantly reduced with the reconstruction of existing furnaces and the installation of a water treatment plant, those capital projects could not be financed under its previous financial situation. The old furnace design also resulted in less-than- optimal energy usage in production.

Upon privatization, O-I brought in new working capital and negotiated a long term loan to finance Jaroslaw's investment plan, a major component of which was the reconstruction of all of the existing furnaces. The 1994 investment plan also includes a new water treatment plant. The capital investment plan is expected to bring Jaroslaw into complete compliance with Poland's environment regulations within four years. In addition, the existing recycling program will be expanded to increase the regional collection of glass to be used as raw materials.

3. Lessons Learned from Jaroslaw's Privatization and Post-Privatization Experience

Several lessons could be learned from Jaroslaw's experience in undergoing the transition from an SOE to a private company. The first lesson relates to the tradeoff between short-term government revenue and investment in the company. The second is associated with the management rights of workers in a privatized enterprise. Third, Jaroslaw's post-privatization experience provides an example of the pace and approaches to be adopted in the restructuring process.

<u>Short-term Government Revenue Versus Investment in Enterprise</u> In the share sale transaction with O-I, the Government received $3.15 million in cash from O-I for 36 percent of Jaroslaw's shares. While O-I was unwilling to pay MOP for the outstanding shares (44 percent for $3.85 million) immediately, O-I and its financial partners made an additional capital investment of $14.05 million in Jaroslaw simultaneously with the share purchase. The authors have been informed that a competitor bid from PLM and Heye JV would have provided MOP with a higher cash payment up front.

However, the structure of the O-I offer, in particular the increase in paid-in capital, proved to be critical to restoring Jaroslaw's solvency and setting the company on the course of productivity and market growth. The Government has essentially traded short term revenue for the long-term financial health of the enterprise, which in turn will bring future revenue in the form of tax receipts.

Workers Versus Management in Decision-Making Authority As discussed in the previous section under corporate governance, the workers have basically relinquished their management rights and responsibilities with the privatization process. Prior to the company's transformation, workers' interests were represented by the Workers' Council. After transformation, the workers were represented by three seats on the Supervisory Board of the Company (the workers lost those seats after the privatization sale of the company). Prior to the share sale, the management authority of the workers was evident with the dismissal of the Managing Director in mid-1993 when the workers felt that their interests were not adequately protected by management during the process of investor selection.

As of the share sale to O-I in December 1993, the workers no longer have representation on the Supervisory Board or the Management Board. From discussions with union representatives in Jaroslaw, the authors learned that they were cognizant of the implications of privatization on their management rights. Union leaders expressed the view that management tasks would be better left with experienced managers and industry experts, while workers' interests in employee-related issues can be handled through collective bargaining and wage negotiations.

An important lesson learned here is that while the management structure of privatized SOEs may be changed to reflect ownership changes, workers' interests can still be effectively expressed through channels within the private company framework.

Expedient Changes Versus Stable Transition

Another lesson can be learned by managers of recently privatized enterprises from the pace and approaches adopted by Jaroslaw's new management in the enterprise restructuring. The new management of Jaroslaw was faced with many restructuring challenges, several of which would have direct and immediate impacts on its employees. These included management reorganization, treatment of social assets, and labor retrenchment. Instead of implementing swift, drastic changes, management opted for a gradual and evolutionary approach characterized by consistency and honest communications with employees.

For instance, the new Managing Director retained all the former deputy directors and assigned them to positions which would best utilize their expertise. This approach provided management continuity and enhanced overall company stability in the reorganization process. For the sensitive issue of labor downsizing, new management gave union leaders honest and consistent estimates throughout the negotiation process, and has actively solicited their views and concerns to come up with a compensation package. This strategy helped to establish trust and confidence between workers and management. Had management adopted a more top-down, "shock therapy" approach in restructuring the company, they would have encountered more resistance and less cooperation from the workers, which in turn would be disruptive to production.

Ensuring labor peace, however, came at a cost to the company. Retaining 400-450 redundant workers would delay the labor cost savings of an estimated $1 million in the first year.

HUTA SZKLA "JAROSLAW" S.A.

TEACHING NOTE

Case and Audience

The Huta Szkla Jaroslaw S.A. (Jaroslaw) case has been developed as a teaching case study for use in privatization and post-privatization training programs. Program participants are likely to be government officials with responsibility for privatization or post-privatization programs. Managers from the privatized companies also would likely participate in training programs utilizing this case study.

Learning Objectives

The Jaroslaw Case can be used to expose students to the different types of interventions required to restructure recently privatized companies. In particular, this case highlights several restructuring issues commonly faced by privatized SOEs, including:

(1) Prioratizing actions in restructuring privatized enterprises.

(2) Developing a market strategy.

(3) Reorganizing the management team and the management structure to adapt the company to a new operating environment.

(4) Designing a labor strategy especially with respect to labor force downsizing.

(5) Other critical areas of intervention to make the privatized SOE viable.

(6) How a strategic foreign investor should work with existing management to take advantage of their areas of expertise.

Discussion Questions

1. How would you prioratize actions which should be taken in the marketing and production operations management areas in Jaroslaw? In particular, in which areas should investments be targeted in the short term?

2. What are the opportunities and risks presented in the market environment facing Jaroslaw? What types of market strategy can help Jaroslaw utilize its competitive advantage in this market context?

3. What should Adam Kowalski suggest to Mr. Jones in reorganizing Jaroslaw's company structure to reflect the functional divisions in a typical private sector company?

4. Owens-Illinois has decided to bring in two expatriate managers as the Managing Director and the Finance Director. What factors should be considered in deciding the fate of the two displaced directors? How would the skills of the two expatriate directors be best utilized in Jaroslaw?

5. What would you consider as the important elements of a successful labor strategy for Jaroslaw? What measures would you recommend to make the retrenchment process less painful for Jaroslaw's employees? What are the tradeoffs between expedient changes and stable transition?

6. Recently privatized companies often require more than one type of intervention to improve profitability and ensure viability. What other areas of intervention (outside of Adam Kowalski's immediate decision focus) would be needed by Jaroslaw to improve its operations?

7. What kind of resources can O-I provide Jaroslaw in its restructuring process and how could those resources be effectively utilized? In what areas would the Polish managers make the most contribution to the privatized company?

8. Of the challenges facing Jaroslaw, which ones do you think would be typically experienced by other private companies, and which ones are particular to the restructuring of privatized SOEs, especially in the Polish context?

Discussion

1. **<u>How would you prioratize actions which should be taken in the restructuring of Jaroslaw? In particular, in what areas should investment funds be targeted in the short term?</u>**

Compared to many other recently privatized companies in former socialist economies, Jaroslaw had the advantage of starting off with sound financial health and a clean balance sheet. While the company was basically profitable, there was a creeping sense that resources were not being efficiently utilized, and the company's potential not fully exploited. Thus, actions that need to be taken would not be characterized as crisis management but should reflect a strategic plan to improve Jaroslaw's competitiveness and viability in the long term.

Jaroslaw occupied a cozy market position in Poland as of January 1994, having established a reputation as a cost-competitive, high quality, high volume producer. However, market trends pointed to the possibility of technology and quality upgrading among its competitors, posing potential threats to Jaroslaw as a dominant supplier. In the future, market competitiveness would increasingly depend on Jaroslaw's ability to meet customers' specification, quality, delivery and service requirements while staying cost-competitive. Thus, one of the major priorities of management would be to improve the efficiency of Jaroslaw's production operations as well as its product quality and variety. The investment funds made available by the EBRD loan had created just this kind of opportunity.

Generally speaking, managers should prioritize investment decisions according to the returns they yield. In the case of Jaroslaw, to calculate the returns to a single set of equipment, the student realistically would require information on the stream of incremental cash flow generated by that particular equipment, in addition to the flow of associated operating, depreciation, maintenance and other costs. Unfortunately, it would be prohibitive to provide information in such detail in this case study. Nonetheless, the instructor could guide students through an illustrative exercise in calculating such cost and benefits, given the limited information made available to students in the case.

For production operations, for example, students could be asked to calculate the returns to investment in one new furnace. The replacement of one furnace would cost approximately $10 million. Fuel consumption could be reduced by 30 percent, while furnace output would also be raised by over 60 percent.

Given the manufacturing costs breakdown provided in Exhibit 14, students could calculate the fuel (gas) cost for one furnace over one year, at the exchange rate of Zl. 16,553 per US Dollar (average exchange rate for the first six months of 1993). Such calculations would yield an estimate of over $470,000 in cost savings from reduced fuel usage per year. The increase in output could potentially bring over $6.7 million in increased revenue per year (this figure could be extrapolated from the sales revenue provided in Exhibit 2). On top of a baseline profit margin of 17 percent, this could mean an additional $1.2 million in profit each year. Given these illustrative figures, students can be guided to calculate the net present value of investment in the furnaces over a ten year period.

Similar calculations could also be made on the investment in a new water treatment plant. To arrive at the estimated rate of return on this investment, students can use the estimated $1 million construction cost of the plant, and the potential savings of over $100,000 in annual fees and fines through full compliance with environmental regulations. There are also other costs and benefits that are not quantifiable. For example, there could be incremental administrative costs associated with discussions with regulatory authorities over these issues. There could also be costs associated with damagers to the firms' reputation for non-compliance which should be taken into account in the decision-making process.

2. **What are the opportunities and risks presented in the market environment facing Jaroslaw? What types of market strategy can help Jaroslaw utilize its competitive advantage in this market context?**

The marketing environment has changed rapidly for Jaroslaw over the past few years. As a result of the disintegration of the former Soviet trading bloc, previous marketing arrangements have collapsed and many of Jaroslaw's former clients are insolvent. While there are more opportunities and flexibility in a market-based environment, Jaroslaw also can no longer rely on cozy sales relationships with former SOEs. The market will be increasingly competitive, and competition will move from price to areas of quality, delivery, and the capability to meet client specifications.

Between 1991 and 1993, Jaroslaw has relied less on the export market for sales and revenue. In 1993 export revenues as a percentage of total revenue was less than half of the 1991 level (Exhibit 10). By contrast, a smaller decline was seen in export volumes, which could indicate declining profitability of export sales compared to domestic sales. However, the new market environment also presents Jaroslaw with export opportunities with both its western and eastern neighbors. While export sales help to diversify from the domestic market base, export sales also expose the company to foreign exchange risks caused by the fluctuation in the value of the Zloty against other currencies.

In the design of a market strategy for Jaroslaw, students will be guided to discuss the comparative advantages of Jaroslaw, which include:

- Its current market presence and position as an established supplier in Poland;
- Its reputation as a quality and low cost supplier;
- Its affiliation with O-I which provides it with exclusive sales arrangement with Alima-Gerber;
- Its strong financial position as a result of privatization, which provides a stable and strong base for long-term capital investment; and

- Its proximity to the border with Ukraine, which positions it to export to its eastern neighbors.

A good marketing strategy will build on Jaroslaw's competitive advantages and will have the following elements:

- Improve image and brand recognition of Jaroslaw to enhance loyalty among the existing customer;

- Focus on quality, service, and client satisfaction to increase product differentiation and brand loyalty;

- Use the alliance with Alima-Gerber as a source of steady business, while diversifying to spread market risks; and

- Focus on the domestic market where Jaroslaw's products are superior in quality and price, while selectively expanding in export markets as part of a diversification strategy.

3. **<u>What should Adam Kowalski suggest to Mr. Jones in reorganizing Jaroslaw's company structure to reflect the functional divisions in a typical private sector company?</u>**

The existing company structure, as shown in Exhibit 6, reflects the management priorities and procurement and marketing practices under a socialist economic environment. Students should be encouraged to explore alternative ways to reorganize Jaroslaw's company structure to reflect the functional divisions of a private sector company, such as production, marketing, personnel, finance, business office, purchasing, and legal departments. In particular, students should be encouraged to explore the following areas:

- In Jaroslaw both marketing and procurement functions have been assumed by the Trade Director. This organization reflects the practices of allocating goods in a socialist economic environment, in which procuring supplies and selling products required similar approaches - making phone calls to familiar suppliers and customers and negotiating delivery volumes without regard to market competition. Under a new market-oriented operating environment, procurement and marketing will require very different skills and thus should be separated functionally.

- In view of the difficult labor retrenchment and personnel issues faced by the new management, it would be appropriate to establish a personnel department to include functions such as general personnel policy, training, labor liaison, safety and health issues, and perhaps quality control.

- Under its previous SOE structure, a variety of functions were placed under the direct supervision of the General Director, such as legal advise, economics, quality control, and general administration. The new Managing Director can delegate responsibility in many of these areas to other Directors.

4. **Owens-Illinois has decided to bring in two expatriate managers as the Managing Director and the Finance Director. What factors should be considered in deciding the fate of the two displaced directors? How would the skills of the two expatriate directors be best utilized in Jaroslaw?**

The two former directors displaced by the new O-I managers include Mr. Nowak (Managing Director) and Ms. Gora (Finance Director). In addition, Mr. Kupin, the Managing Director replaced by Mr. Nowak in mid-1993, is still with the company. Several factors should be considered in deciding the fate of each of the displaced managers:

- Is he/she open-minded, receptive and adaptive to changes?
- Does he/she have a rapport with workers and the unions and will his/her dismissal cause disruption in the production and management environment?
- If the manager is to be retained, what would be a particular area in which he/she can make the most contribution in his/her area of expertise?

Exhibit 1 in Case B provides the organization chart of the restructured company, which should be viewed as one of the feasible approaches but by no means as the only approach.

Given his management experience and labor relations skills, Mr. Jones, the new Managing Director, would be best suited to deal with larger organizational and restructuring issues and the sensitive issue of labor retrenchment. Mr. Smith's experience and skills with financial management and cost control can be utilized in dealing with lending institutions such as EBRD, as well as Jaroslaw's financial investors. Mr. Smith can also play a leading role in setting up a financial management system to implement tighter cost controls in the company's operations.

5. **What would you consider as the important elements of a successful labor strategy for Jaroslaw? What measures would you recommend to make the retrenchment process less painful for Jaroslaw's employees? What are the tradeoffs between expedient changes and stable transition?**

Elements for a successful labor strategy:

- Honoring commitments to employment and social service guarantees, wage increases, and improvements to safety and health conditions to establish workers' trust in the new management.

- Honesty and consistency in dealing with unions on the subject of redundancy to minimize confusion, suspicion and unnecessary speculation, and help gain workers' support in the process.

- Instilling morale, pride and loyalty among the employees by putting a new emphasis on product quality, customer service, training and improvements in factory appearance and facilities.

To make the retrenchment process less painful for the employees:

- Be generous and flexible in the design of severance packages, which will make voluntary separation a more attractive option for employees. Providing a 6-month severance pay to about 400 separated employees is estimated to cost $500,000 - $700,000.

- Allow workers ample time to consider voluntary separation packages and, in the case of layoffs, give plenty of advance notice to allow employees to make optimal employment decisions.

- Encourage and support alternative employment opportunities to help make severance less painful. In the case of Jaroslaw, the management can contract services out to separated employees and act as an initial customer base, lease out equipment to perform those services on preferential terms, or establish a small business loan program to encourage entrepreneurship.

The advantages of implementing speedy labor retrenchment are: (i) to send a clear and strong message to the employees that the new management is determined to carry out enterprise restructuring; and (ii) to immediately reduce direct production costs through lower payroll cost. Payroll costs could be potentially reduced by $1 - $1.4 million per year if 400 employees were laid off. The disadvantages would be the shock to the retrenched workers, possible disruptions to production, and confrontations between workers and management. In contrast, a slow and

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incremental process of change will give time to workers to become familiar with new management, and to allow the labor strategy to evolve in a process of consultation and consensus.

Since labor cost is only 16 percent of total production costs (Exhibit 14) and Jaroslaw's operation is currently profitable, management does not have to resort to immediate and drastic labor cuts as a cost-reduction measure. In addition, given Jaroslaw's labor turnover rate of 10-12 percent per year, up to 170 employees could voluntarily leave without severance pay in the first year.

6. **Recently privatized companies often require more than one type of intervention to improve profitability and ensure viability. What other areas of intervention (outside of Adam Kowalski's immediate decision focus) would be needed by Jaroslaw to improve its operations?**

Other areas which are critical to Jaroslaw's restructuring process include:

- Financial Management Systems: the priority is to improve capability to provide management with data to implement effective cost control and product costing.

- Plant Operations: modernize the production process to increase efficiency and product flexibility, reduce energy consumption, and improve quality control.

- Labor training: the areas of focus will be new equipment operations, maintenance and repairs, and English language skills mainly for the understanding of manuals and communication with management staff.

- Environmental Priorities: Jaroslaw has not complied with environmental regulations of the Polish authorities due to its waste water discharge and gas emission. Non-compliance has brought fines in the past and will bring additional problems with international lending agencies (e.g. EBRD) in the future. Thus, environmental considerations will have to be an investment priority.

7. **What kind of resources can O-I provide Jaroslaw in its restructuring process and how could those resources be effectively utilized? In what areas would the Polish managers make the most contribution to the privatized company?**